

Machinery or equipment used to transport work in progress, or semifinished goods, between plants does not qualify for the manufacturing machinery and equipment exemption.. See 86 Ill. Adm. Code 130.330. (This is a GIL).

December 21, 2000

Dear Xxxxx:

This letter is in response to your letter dated August 3, 2000. We apologize for the extended delay in responding to your inquiry. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

In your letter, you have stated and made inquiry as follows:

The purpose of this letter is to request an Administrative Ruling from the Illinois Department of Revenue on behalf of our client (hereafter referred to as 'the Company') regarding the application of Illinois sales and use tax to purchases of industrial machinery and equipment used in the manufacturing process. Additionally, we request a ruling related to the application of sales and use tax to purchases of merchandising display shelving and signage by Illinois retailers for in-store use.

### **Issue #1: Manufacturer's Sales & Use Tax Exemption**

#### ***Facts***

The Company is a manufacturer of various types of clothing, which it sells on a wholesale basis, to retailers such as COMPANY1, COMPANY2 etc. for resale to customers. The manufacturing process for the garments often begins in one plant and continues through several plants as goods-in-process until the finished product is completed in the final plant and is ready for sale. Various types of industrial machinery and equipment are used in the integrated manufacturing process. This process is typical for the industry in that it can be segregated into three functional segments: (1) Receiving; (2) Manufacturing/Processing; and, (3) Distribution.

- 1) Receiving involves the movement of unfinished materials from trucks into the materials storage area. To accomplish this receiving function, equipment such as forklifts, conveyors, reusable transport containers and other material storage and handling devices are utilized. Upon receipt the unfinished material is temporarily

held on racks and shelving located in the storage area until ready for the continuation of the manufacturing process.

- 2) Manufacturing/Processing involves the introduction of unfinished materials onto the production line where it is transformed from one state to another. This transformation includes, but is not limited to, knitting, dyeing, cutting, sewing, washing, pressing and packaging. To accomplish this Manufacturing/Processing function, many types of equipment are utilized. These include: weaving looms, dye tanks, computerized cutting machines, sewing machines, washers and dryers, steam presses and packaging equipment.
- 3) Distribution involves the movement of partially finished materials from the production line into another temporary storage area. When ready for shipment, the goods-in-process are moved from storage onto trucks where they are transported to other plants for further Manufacturing/Processing, or at the last plant, the finished goods are transported to the Company's customers. To accomplish this distribution function, equipment such as forklifts, conveyors, reusable transport containers and other material storage and handling devices are utilized.

### ***Discussion***

Illinois provides for manufacturers, a complete or partial exemption from sales and use tax on qualifying purchases of industrial machinery and equipment used in the manufacturing process. This exemption is evidenced in Illinois Code 35 ILCS 120 Sec. 2-5(14) and is generally limited to machinery and equipment which are used directly in the Manufacturing/Processing function. However, normally excluded from this exemption are machinery and equipment used in the receiving, distribution or other non-Manufacturing/Processing functions. The theory behind the exclusion of non-Manufacturing/Processing purchases is that the exemption should apply only to machinery and equipment used to transform or alter material from its original state, and also when the materials are being moved from one stage of production to another. In cases where the manufacturing process begins and ends in one facility, it is logical to withhold the exemption from the receiving of raw materials and the distribution of commercially marketable finished goods.

However, this is not the case for our client. The various Manufacturing/Processing functions described above occur within four separate yet integrated plants, each situated several miles from the other. Although, geographically separate, the four plants function as one manufacturing/processing plant. Plant A performs knitting and dyeing of the fabric; Plant B performs cutting of the dyed fabric; Plant C performs the sewing of the cut fabric pieces into garments; and, Plant D performs the washing, drying, pressing and packaging of the garment for shipment as commercially marketable product. Collectively the four integrated plants make up one continuous manufacturing process. No single plant manufactures a finished commercially marketable product. The transportation and handling of the unfinished piece goods from Plant A to Plant D are no different than the movement of materials along one continuous production line. In this case, the raw materials enter Plant A and the commercially marketable finished products exit Plant D. As such, the exclusion from Illinois's Manufacturer's Sales Tax Exemption, should be limited to receiving equipment used at Plant A and distribution equipment used at Plant D. Other receiving and distribution equipment such as forklifts,

conveyors, reusable transport containers and other material storage and handling devices used to temporarily contain and move the partially finished materials from plant to plant are clearly consistent with the spirit of the law, and should be recognized as being included in the exemption.

In considering this exemption, it is important to recognize the purpose behind its creation. Obviously, Illinois wants to encourage and foster existing manufacturing business and also compete for the creation of new manufacturing business including the jobs, investment and commerce that such business brings to the state. These are economic benefits for which each state competes. Limiting the exemption to small self-contained manufacturing plants would not be consistent with this purpose and would unduly penalize the larger manufacturers. Presumably, the larger the manufacturer, the greater the benefit they bring to the state.

### ***Summary***

Based on the above facts and discussion, we respectfully request affirmative rulings from the Illinois Department of Revenue as follows:

- 1) For integrated plants within Illinois, the manufacturing process begins in Plant A and ends in Plant D. Consequently, only receiving equipment in Plant A and distribution equipment in Plant D should be excluded from the exemption. All other receiving and distribution equipment utilized between Plants A and D should qualify for the manufacturer's exemption.
- 2) For plants which are part of an integrated multi-state Manufacturing/Processing network, the manufacturer's exemption should apply to receiving and distribution equipment purchased by each plant provided it is not the first or last plant in the integrated manufacturing process. If such plant were first in the manufacturing process, then receiving equipment should be disallowed while distribution equipment should qualify for exemption. If such plant were last in the manufacturing process, then distribution equipment should be disallowed while receiving equipment should qualify for exemption.

### **Issue #2: Display Shelving and Signage Purchased by Retailers**

#### ***Facts***

The Company offers a co-operative advertising plan ('co-op plan'), which provides co-op advertising support for retail advertising of its products. The plan is offered on a proportionately equal basis to all retailers (e.g. COMPANY1, COMPANY2, etc.) in the United States. Retailer co-op funds are accrued by the Company, on behalf of the retailers, into a single trust fund from purchases made by retailers. Participating retailers realize co-op funds at a rate of 2% of qualifying purchases of the Company's clothing products. Qualifying media advertising, visual merchandising shelving, signage and other items are reimbursed from the collective fund at up to 50% of the cost price. Purchases of merchandising shelving and signage can occur by three methods:

- 1) The retailer can arrange for the purchase and shipment of promotional shelving and signage to its own stores located in Illinois. The shelving and signage manufacturer's invoice will note the retailer as the 'sold to' and 'ship to' entity.

The retailer will receive the invoice from the shelving and signage manufacture, which will be paid by the retailer. The retailer will then submit the shelving and signage invoice to the Company for reimbursement of 50% of the cost price. The Company issues a check to the retailer for 50% of the cost price, which is paid from the retailer co-op trust fund. If a retailer submits claims for shelving and signage purchases, which are in excess of the amount of retailer co-op money accrued, the retailer will be billed for any deficiencies at the end of the co-op plan year.

- 2) Same facts as number one except, the Company arranges for the purchase and shipment of promotional shelving and signage on behalf of the retailer customer. The Company will be noted as the 'sold to' and in some cases the 'ship to' entity on the invoice. However, the Company does not obtain possession of the shelving and signage; they are drop shipped directly to the retailer stores. The Company will pay the invoice which it receives from the shelving and signage manufacturer out of funds from the retailer co-op trust fund and will bill-back the retailer for the retailer's 50% share of the cost of the shelving and signage. The retailer's 50% payment back to the Company will be credited back to the retailer's co-op trust fund. If a retailer has insufficient co-op funds to pay for shelving and signage claims, the retailer will be billed for any deficiencies.
- 3) Same facts as number two except, the Company does obtain temporary possession of the shelving and signage; however, they are subsequently transported to the retailer store locations. Again, the Company will pay the invoice which it receives from the shelving and signage manufacturer out of funds from the retailer co-op trust fund and will bill-back the retailer for the retailer's 50% share of the cost of the shelving and signage. The retailer's 50% payment will be credited back to the retailer's co-op trust fund. Again, if a retailer has insufficient co-op funds to pay for shelving and signage claims, the retailer will be billed for any deficiencies.

In all three cases, payment from the retailer co-op trust fund cannot exceed the amount of retailer funds available. If a retailer submits claims for shelving and signage purchases, in excess of the amount of retailer co-op money accrued, then the retailer will be billed for any deficiencies. One retailer cannot use the funds of another retailer, the funds are non-transferable.

### ***Discussion***

Method #1 is clearly a purchase by the retailer of shelving and signage for use in its Illinois stores. The Company is not a party to the original purchase transaction and therefore has no sales or use tax payment responsibility. This method is a straight reimbursement to the dealer, from its own accrued retailer co-op advertising funds. This situation is similar in nature to employees being reimbursed by their business for travel and entertainment expenses. Any taxable event occurs at the initial point of purchase and is complete upon closure of the sale. To avoid double taxation or pyramiding of tax, reimbursement of expenses is not a taxable event for sales and use tax purposes.

In methods #2 and #3, the Company is acting as a purchasing agent for the retailer. While the form of the purchase method is somewhat altered, the substance of the transaction remains essentially the same as method #1. In method #2 the Company

never obtains possession of the shelving and signage, which are dropped shipped to the retail store in Illinois. In method #3 the Company obtains temporary possession of the shelving and signage only until final shipping arrangements can be made for the Illinois retailer. In all three cases the Company does not retain possession of the shelving and signage because, as a manufacturer, it has no use for retail store merchandising shelving and signage. After the retailer has used the shelving and signage and they become obsolete, the retailer disposes of them. The Company does not collect or repossess any shelving and signage. Failure to properly display the Company's clothing on the shelving may be cause for disqualification in the co-op advertising program, however the Company does not take back the shelving and signage.

In each case, the retailer is, in essence, purchasing the shelving and signage with its own funds—half of which are coming directly from the retailer and half coming from a fund held in trust for the benefit of the retailer. All three scenarios are in substance the same, the retailer is purchasing shelving and signage with its own combined funds for its own retail store use. This is supported by the fact that, in any situation where the retailer submits invoices for payment from the trust fund, who does not have sufficient accrued retailer funds for payment, the retailer will be billed by the Company for payment of the shelving and signage invoices. Furthermore, it is the retailer (not the Company) who instigates the purchase of the shelving and signage and causes them to be imported into Illinois for use in its retail stores. The Company is simply assisting the retailer in the management and coordination of the shelving and signage purchase. Consequently, in all three cases payment or accrual of sales and use tax on shelving and signage purchases is the responsibility of the retailer and not of the Company.

### ***Summary***

Based on the facts and discussion above, we respectfully request a response in the affirmative as follows:

The purchase and use by the retailer of merchandising shelving and signage are taxable to the retailer based on the point of final delivery. Since the retailer is causing the shelving and signage to be imported into Illinois for use in their retail stores, appropriate Illinois sales tax should be paid or self-accrued and remitted to the Illinois Department of Revenue by the retailer, based on the total purchase price of the shelving and signage.

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We appreciate your consideration in this matter. If you need additional information or, if the Department of Revenue is inclined to disagree with our conclusions as described herein, please contact me prior to issuing your response.

## **MANUFACTURING MACHINERY AND EQUIPMENT**

Machinery and equipment that is used primarily in the manufacturing or assembling of tangible personal property for wholesale or retail sale or lease is exempt from Retailers' Occupation Tax. See the enclosed copy of 86 Ill. Adm. Code 130.330. The manufacturing process is the production of any article of tangible personal property, whether such article is a finished product or an article for use in

the process of manufacturing or assembling a different article of tangible personal property, by procedures commonly regarded as manufacturing, processing, fabricating, or refining which changes some existing material or materials into a material with a different form, use, or name. These changes must result from the process in question and be substantial and significant.

As recognized in your letter, the Department's administrative rules provide that machinery or equipment used to store, convey, handle or transport materials or parts or sub-assemblies prior to their entrance into the production cycle do not generally qualify for the manufacturing machinery and equipment exemption. See Subsection (d)(4)(C) of the enclosed copy of Section 130.330. In addition, machinery or equipment used to store, convey, handle or transport finished articles of tangible personal property to be sold or leased after completion of the production cycle do not generally qualify for the manufacturing machinery and equipment exemption. See Subsection (d)(4)(D) of the enclosed copy of Section 130.330.

Subsection (d)(4)(E) of the enclosed copy of Section 130.330 of the Department's administrative rules regarding the manufacturing machinery and equipment exemption specifically provides that the "use of machinery or equipment to transport work in progress, or semifinished goods, between plants" will generally not qualify for the manufacturing machinery and equipment exemption. Forklifts, conveyors, and other handling devices used to move the partially finished goods between plants would generally not qualify for the exemption. Please note that some of the reusable transport containers may qualify for the manufacturing machinery and equipment exemption under the holding in Zenith Elec. Corp v. Department of Revenue, 293 Ill. App. 3d 651 (1st. Dist. 1997).

Please note that even though the forklifts, conveyors, and other handling devices used to move the partially finished goods between plants would not qualify for the manufacturing machinery and equipment exemption, those devices would likely qualify as production related tangible personal property for purposes of use of Manufacturer's Purchase Credit. In the State of Illinois a manufacturer earns Manufacturer's Purchase Credit (MPC) on the purchase of tangible personal property that qualifies for the manufacturing machinery and equipment exemption. See the enclosed copy of 86 Ill. Adm. Code 130.331. MPC may be used to satisfy Illinois Use Tax or Service Use Tax liability that is incurred on the purchase of production related tangible personal property that does not qualify for the manufacturing machinery and equipment exemption.

## DISPLAY MATERIALS

For Method number 1 listed above, the manufacturer is providing a monetary reimbursement of the retailers' costs incurred in purchasing certain signs and shelving or other advertising and display merchandise. The purchase of the display and advertising materials by the Illinois retailer would be a taxable purchase and it would incur a Use Tax liability on the cost of those materials. The seller would incur Retailers' Occupation Tax liability or Use Tax collection liability depending upon whether the seller of those materials had sufficient sales tax nexus with Illinois. The partial or full reimbursement of the costs of those materials by the manufacturer to the retailers would not generally be subject to either Retailers' Occupation Tax or Use Tax liability.

For Method numbers 2 and 3 listed above, a different taxable situation exists. The manufacturer under both scenarios 2 and 3 above would generally be considered to be making purchases for resale of the display merchandise. The manufacturer would be considered to be providing the display merchandise (to the extent of the amount provided in the "co-op plan") as part of the sale of its clothing merchandise. See Boye Needle Co. v. Dept. of Revenue, 45 Ill.2d 484 (1970). The manufacturer may purchase the display merchandise without incurring tax as a sale for resale.

See the enclosed copies of 86 Ill. Adm. Code 130.1401 and 130.1405. This analysis would be the same regardless of whether the display merchandise is drop-shipped or not by the manufacturer.

However, if the manufacturer makes a charge to an Illinois retailer for the display merchandise (such as when a retailer's claim exceeds the retailer's accrued co-op amount), then the manufacturer is acting as a retailer of that display merchandise apart from its sale of clothing. If the sale occurs in Illinois, the sale would be subject to Retailers' Occupation Tax liability. Even if the sale occurs outside of Illinois, the manufacturer may be required to collect its Illinois customer's Use Tax liability depending upon whether the manufacturer has sufficient sales tax nexus with Illinois.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at [www.revenue.state.il.us](http://www.revenue.state.il.us). If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b) described above.

Very truly yours,

Terry D. Charlton  
Associate Counsel

TDC:msk  
Enc.